

ILF Conference at Frankfurt am Main
January 29, 2018
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“Basel III - Are we done now?”

Thank you very much for giving me an opportunity to express our views representing Asia to so many distinguished experts.

General View on Basel III from Asian Perspectives

The finalization of Basel III is the final piece of post-crisis reforms (except for final review of the revised market risk framework) and expected to remove regulatory uncertainty. From the viewpoints of Asia which is located between the two major financial markets US and Europe, the finalization of Basel III is particularly welcomed because it would help maintain the multilateral framework of banking regulations and prevent fragmentation of global markets.

We respect the US authorities which supported the Basel framework under the current US administration advocating the policy of “America First”. We also respect European authorities which finally accepted the compromise package despite diverse interests of European jurisdictions.

Japanese industry and general public showed at least lukewarm welcome to the agreement for the first time in the history of the Basel Committee. The extended negotiation period of last year, in my view, has caused Japanese banks significant anxiety and, as an unintended but favorable consequence, made them fully aware of the importance of multilateral regulatory framework underpinning their global activities.

In terms of overall impact of the finalization of Basel III, capital requirement on Asian banks tend to be lessened because many of them use standardized approaches (or less advanced models) for risk weighted asset calculations and do not heavily rely on internal models, while actual impacts depend on how Basel III will be implemented in each jurisdiction.

On the other hand, major Japanese banks will face large increases in their capital requirements. They, however, appreciate the final adjustment made by the Basel Committee concerning constraints on the IRB approaches to balance risk-sensitivity with comparability and simplicity.

Characteristics of Asian Banks and Implication of Basel III

Basel III has introduced additional constraints such as an aggregate output floor and input floors on the IRB approaches in order to address excessive variability of risk weighted asset calculations. These measures may have different impact on each bank depending on its adopted business model. Asian banks, most of which are regarded as commercial banks, usually hold loan assets on their balance sheets until repayment and put more emphasis on internal credit assessment than investment banks. Thus, we need to carefully monitor whether these measures may unduly affect commercial banks vis-a-vis investment banks.

We need to carefully monitor how Basel III affects financial intermediation to SMEs which play important roles in Asian economies. The standardized approach on credit risk under Basel III has lowered risk weight for unrated SMEs from 100% to 85%, while there are other elements in Basel III such as the output floor that could have adverse impact on SME financing.

Basel III may also affect trade finance which supports Asian economies by facilitating international trade. Under Basel III, capital requirements for bank exposures will be increased by removal of both the AIRB approach and a certain standardized approach based on the creditworthiness of sovereign of its incorporation. Since trade finance usually relies on other banks' guarantee, these measures could in turn negatively affect trade finance in the Asian region.

In addition, Basel III may affect infrastructure financing which is essential for sustainable growth of Asian economies. Since banks play important roles even in long-term financing in Asia, people are concerned about impact of amendments to the treatment of specialized lending under Basel

III.

There are other concerns as well. The new risk-sensitive framework of standardized approach concerning real estate financing (i.e. risk weight tables using LTV ratios) would probably increase the overall capital requirement for those exposures, while they are expected to promote banks' robust risk management and to help prevent overheating of Asian property markets. Also, the heightened risk weights for equity holdings (i.e. 250% risk weight) implies significant increase of capital requirement for Asian banks, especially for Japanese banks, while it is expected to help reduce cross-shareholdings with large corporates. Accordingly, these measures should be appropriate especially for Asian jurisdictions from macro-prudential view-points.

What remains to be done

Though we have finalized the rule-making phase of Basel III, we are still facing significant challenges in its implementation phase. Since Basel rules concerning risk weighted asset calculations involve significant implications on level playing field concerns, it is all the more important for every jurisdiction to implement them in a globally harmonized manner. To be frank, Asian regulators are proud of our excellent track records in implementing Basel rules. Therefore, we would like to urge other major jurisdictions to implement Basel III faithfully in accordance with the agreed timeline.

In addition, it is important for us to evaluate effects of Basel III as well as its combined effects together with other post-crisis reform measures. The JFSA has been claiming that we need to achieve not only financial stability but also economic growth by post-crisis reforms. In this respect, we are encouraged by the fact that both the Basel Committee and the FSB already embarked on impact assessment exercises and expect them to cover the areas I already mentioned. I believe we should not hesitate to make necessary adjustment if we find any unintended consequences.